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SEC CALLS FOR BETTER MD&A DISCLOSURE

Steven Amen and Lisa Sarver of our Omaha, NE office write:

On December 19, 2003 the SEC issued an interpretative release providing further guidance on companies improving the quality of their disclosures in the Management Discussion and Analysis section of their 10-K and 10-Q filings. Because this is the section that often causes SEC investigations and shareholder lawsuits, the guidance is critical as companies adjust to new corporate governance standards.

In the release, the SEC emphasized that the purpose of the MD&A is to provide "a discussion and analysis of a company's business as seen through the eyes of those who manage the business." To help investors understand changes in the company during the year, the SEC suggests that a company:

- Have an executive summary at the beginning of the MD&A;
- Display the most important information prominately;
- Avoid limiting the disclosure to just a recitation of changes in financial statement amounts from year to year; and
- Add a discussion of key financial and non-financial performance indicators that management itself uses in running its business.

The release (http://www.sec.gov/rules/interp/33-8350.htm) also addresses the discussion of liquidity and capital resources, emphasizing that this section should identify how the company will generate the funds necessary to maintain current operations, complete projects underway and achieve stated objectives.

The SEC has advised that it will continue to review the MD&A section and take action as appropriate.

<u>*IN THIS ISSUE:*</u>

- SEC Calls for Better MD&A Disclosure
- Reminder: Disney Case Highlights the Risk of Poor Corporate Governance
- New OCC Rules Strengthen National Bank Charters

If you would like more information on these topics or have any questions, please e-mail us at CorporateNotes@KutakRock.com.

■ REMINDER: DISNEY CASE HIGHLIGHTS THE RISK OF POOR CORPORATE GOVERNANCE

Given the new listing standards issued by the New York Stock Exchange and NASDAQ regarding corporate governance, companies should keep in mind the <u>Disney</u> decision handed down by the Delaware Court of Chancery last year. The court, in <u>In re The Walt Disney Company Derivative Litigation</u>, allowed a shareholder derivative lawsuit to move forward. The lawsuit aims to hold Disney's board members personally liable for the $38 million in cash and $101 million in stock options that were paid to a former president under a five-year agreement, even though the president left the company just a year later. (http://courts.state.de.us/chancery.opinions/15452-126.pdf)

In this case, the shareholders allege that Disney's board members violated their duty of good faith (rather than their traditional duties of due care and loyalty) by:

- Failing to properly review a significant, long term employment agreement for the president;
- Failing to engage a compensation expert to advise them on such a significant contract; and

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- Failing to act when the contract was terminated without board approval less than a year later.

In short, the shareholders claim that the directors abdicated their duties by failing to exercise any good faith in their decisions.

Claims such as these significantly raise the risk of personal liability to directors because:

- These claims then become personal rather than being targeted at the corporation;
- Failure to act in good faith could prevent a director from being indemnified under some corporate charters; and
- Acting in bad faith could prevent coverage under D&O insurance.

Directors can reduce their risk in this area by:

- Hiring experts to independently review the appropriateness of proposed contracts;
- Only approving final versions of agreements; and
- Taking action immediately if management acts outside of its authority.

■ NEW OCC RULES STRENGTHEN NATIONAL BANK CHARTERS

National bank charters became more powerful, and more flexible, because of two recent rules issued by the Office of the Comptroller of the Currency (the "OCC"), which regulates national banks. (http://www.occ.treas.gov/newrules.htm)

These rules preempt state laws that interfere with a national bank's banking operations. They also streamline the process for a national bank to form a holding company, which helps a bank to better tap the capital markets and diversify operations.

The first rule preempts state laws to the extent they affect the banking operations of a national bank. This is a broad preemption, similar to those enjoyed by federally-chartered savings and loans, and includes key areas such as:

- Collateral insurance/credit enhancement requirements;
- Due-on-sale clauses; and
- Treatment of dormant accounts and escrow accounts.

These are in addition to existing federal law preemption of state laws involving interest rates charged, credit terms allowed and real estate lending limits.

The second rule streamlines the process for obtaining OCC approval to form a holding company, or for a company to acquire an existing national bank and thus become a bank holding company. While OCC approval is in addition to the approval required by the Federal Reserve, which regulates bank holding companies, the rule reduces the approval time by allowing for automatic approval within 30 days after filing if the OCC does not object.

Financial institutions, and investors in potential de novo banks, should consider whether the new advantages of a national bank charter will help them better accomplish their business goals.

Kutak Rock LLP is a national law firm with 340 attorneys located in 17 offices throughout the United States. Our practice includes corporate, banking and securities law, mergers and acquisitions and stock offerings, federal government contracts, and complex commercial litigation.

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